

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)**Corporate Governance Country Assessment****REPUBLIC OF KOREA****September 2003****I. Executive Summary****II. Capital Market Overview and Institutional Framework****III. Review of Corporate Governance Principles****IV. Annexes:**

- A. OECD Principles Assessment Matrix
- B. Recommended Plan of Key Actions to Improve Observance of OECD Principles of Corporate Governance

The corporate governance assessment was completed as part of the joint World Bank-IMF Financial Sector Assessment Program (FSAP) and Reports on the Observance of Standards and Codes (ROSC). It benchmarks the listed sector's observance of corporate governance against the OECD Principles of Corporate Governance and is based on a template developed by the World Bank. This assessment was undertaken by Behdad Nowroozi from the East Asia and Pacific Region of the World Bank, based on a template completed by Professor Kon Sik Kim and on findings of a mission in April 2002. We would like to express our gratitude to FSC, FSS, KSE, FTC, KSDA, KASB, KICPA, KSD, and MOFE for their cooperation and contribution. We would also like to thank private sector firms, accounting firms, the experts on legal issues, investment bankers, rating agencies, and shareholder activists with whom we spoke. This draft has been prepared in collaboration with the Corporate Governance Unit of Private Sector Advisory Services. Colleagues from PSACG, FSP, and IMF provided comments and advice. The ROSC assessment was cleared for publication by the Ministry of Finance in August 2003.

EXECUTIVE SUMMARY

Since 1998, Korea has taken important steps to address the weaknesses that contributed to the economic crisis of 1997. The corporate governance framework has been strengthened significantly. The reform agenda, however, remains unfinished and the equity markets relative to other OECD countries remain underdeveloped.¹

There has been good progress in upgrading accounting and auditing standards and practices, as well as strengthening underlying institutions responsible for setting standards and ensuring compliance.² The Financial Supervisory Commission/Financial Supervisory Services have been established, and the role of the Korean Institute of Certified Public Accountants has been strengthened.³ While significant improvement has been made, efforts should continue to further improve accounting standards and improve accounting and auditing practices.

Large listed companies have been required to establish audit committees of the boards of directors. However, the concept is new and audit committees are generally perceived to be neither effective nor adequately equipped to effectively discharge their oversight responsibilities. Efforts should continue to improve the effectiveness of audit committees, including measures to clarify and strengthen the role and function of audit committees consistent with international best practices; replace statutory auditors with audit committees for smaller companies over time⁴; and upgrade the skills and knowledge of audit committee members. While holding companies are allowed, only several of them have been established. In order to improve transparency and disclosures of *chaebol*-affiliated operations, several measures could be considered, including measures that may change the incentives for large *chaebol* to establish holding companies (e.g. lower taxes).

While significant improvements have been made to increase minority shareholder rights (e.g., by lowering or eliminating threshold ownership requirements) and the ease with which shareholders exercise those rights, further improvements are required. These could include measures to further enhance shareholder rights and to change incentives in order to make cumulative voting more appealing for large listed companies as a means of allowing minority shareholders a greater voice in the selection of directors (where a certain percentage of shareholders request it). Additionally, further steps should be taken to improve the process for nomination of independent directors by, for instance, requiring that at least two-thirds of members of nomination committees be independent directors.

While derivative actions are allowed, these are costly and therefore have been limited so far to

¹ In OECD countries, market capitalization has risen from 50 percent of GDP in 1990 to 131 percent in 1999 before falling somewhat during 2000. In contrast, its share in Korea was 32 percent in year 2000, lower than a decade ago.

² The KASB was established in 1999. Since its establishment, it has promulgated ten accounting standards in the form of statements, and several interpretations. Additionally, KASB has published eight exposure drafts, and three preliminary draft standards, as of April 2003.

³ KICPA is in the process of adopting a revised code of ethics and a comprehensive Continuing Professional Education (CPE) program. Additionally, in the year 2002, more than 2000 auditors have received training on various accounting and auditing topics.

⁴ Under the SEA, establishment of an audit committee is mandatory for listed companies with assets of at least 2 trillion Won. As of December 31, 2001 only 12 percent of listed firms had set up an audit committee.

only a few.⁵ The redress available to shareholders if their rights are violated remains limited. There is no cost-effective way for shareholders to seek redress. The draft law submitted to the National Assembly to allow class action lawsuits should be enacted as soon as possible. Securities laws have been amended to require listed companies to have outside directors. However, the concept of independent (outside) directors is new and still not well rooted in Korea.⁶ Additional efforts could include measures to expand the fiduciary duty of directors to shareholders and make it explicit under the law, and to limit liability of independent directors in cases in which they have acted in good faith.

While formal corporate governance rules may not now be substantially different from other OECD countries, corporate governance practices often fall short of the spirit, if not the letter, of the OECD principles. The challenge now lies in implementation and effective enforcement of legislative changes to improve the corporate culture and practices.

I. CAPITAL MARKET OVERVIEW AND INSTITUTIONAL FRAMEWORK

As of December 2001, the total market capitalization of listed firms on the Korea Stock Exchange (KSE) amounted to about 256 trillion Won--about 49.5 percent of the country's GDP (517 trillion Won). The turnover ratio in 2001 was 599 percent, up from 97.2 percent in 1996. The total trading volume of stocks in the KSE was 116,417 million shares. Free float estimates are not available. Although functionally not distinguishable, the KOSDAQ stock market is primarily designed for smaller and younger technology oriented firms. The KOSDAQ is much smaller than the KSE about one-fifth the size of the KSE. As of 2001, the number of shares registered with the KOSDAQ market was 8.4 billion, and its total market capitalization was 51.8 trillion Won, about 10 percent of the country's GDP (as of 2001).

The principal law governing stock corporations is the Commercial Code (CC), and the principal law governing the stock markets is the Securities and Exchange Act (SEA). The SEA contains a number of special rules applicable to listed firms. The SEA is implemented by the Financial Supervisory Commission (FSC) with the help of its executive body, the Financial Supervisory Service (FSS). Established in April 1998, the FSC is a consolidated supervisory organization covering the entire financial sector, including banking, securities, and insurance. In addition, a separate commission, the Securities & Futures Commission (SFC), was established under the FSC for monitoring the securities and futures market. The KSE is a self-regulatory organization. The Korea Securities Dealers Association (KSDA) is a self-regulatory organization under the SEA composed of securities brokers. The KSDA has, in principle, power to enforce self-regulatory rules such as the Fair Practice Rules and the Regulation on the KOSDAQ stock market.

II. REVIEW OF CORPORATE GOVERNANCE PRINCIPLES

This review assesses the compliance of Korea to each OECD Principle of Corporate Governance. Each statement is given a benchmark, based upon the country's level of observance of the

⁵ Under the CC and SEA, if a shareholder wins a derivative suit, s/he has the right to demand reimbursement from the company for the action cost and a reasonable amount of other expenses incurred in the course of action.

⁶ In order to help train directors, the Korea Institute of Directors was established in November 2002. Other institutions have also been established recently to train directors and conduct research.

principle.⁷

Section I: The Right of Shareholders

Principle IA. The corporate governance framework should protect shareholders' rights. Basic shareholder rights include the right to: (1) Secure methods of ownership registration; (2) Convey or transfer shares; (3) Obtain relevant information on the corporation on a timely and regular basis; (4) Participate and vote in general shareholder meetings; (5) Elect members of the board; and (6) Share in the profits of the corporation.

Assessment: Largely observed

Description of practice: **(1) Secure methods of ownership registration.** Virtually all shares are issued in registered form in Korea. Registered shares are registered in the Register of Shareholders, which is maintained by the company and subject to the examination of shareholders and creditors. Possession of share certificates constitute proof of legal ownership. Unless registered, a purchaser of registered shares cannot assert her rights against the corporation. In listed firms, a growing portion of shares is now deposited with the Korea Securities Depository (KSD), the official depository. Such shares are registered in the name of the KSD, not the beneficial shareholders. The names of the beneficial shareholders are registered in the Register of Beneficial Shareholders prepared by the company based on the information provided by the KSD. Registered shareholders are to be regarded as lawful shareholders.

(2) Convey or transfer shares. The free transferability of shares is regarded as one of the fundamental principles of corporate law. The CC recognizes only one exception to this principle: a corporation may make a transfer of shares subject to the approval of the board of directors as provided for in the articles of incorporation.

(3) Obtain relevant information on the corporation on a timely and regular basis. Shareholders may obtain relevant information through various means under the statutes. First, the most basic information on a corporation is available from the Commercial Registry. Second, shareholders can examine at any time the articles of incorporation, the minutes of the general shareholders' meetings, the financial statements, business reports, audit reports of the company, and the Register of Shareholders. Third, shareholders with 0.1 percent of the shares (3 percent for non-listed firms) can inspect the accounting records of the corporation.

(4) Participate and vote in general shareholder meetings. Shareholders are entitled to attend the General Shareholders' Meeting (GSM). In practice, shareholders' right to attend the GSM is well respected except for a few extreme cases. If a shareholder is somehow denied attendance, resolutions passed in the particular GSM may be held invalid by the court.

(5) Elect members of the board. Directors are to be elected at the GSM by ordinary majority at least one-fourth of the total shares represented at the GSM. The SEA now requires outside directors to be nominated by an outside director nomination committee, 50 percent of which must be filled with outside directors. Moreover, minority shareholders may put their own

⁷ **Observed** means that all essential criteria are generally met without any significant deficiencies. **Largely observed** means that only minor shortcomings are observed, which do not raise any questions about the authorities' ability and intent to achieve full observance in the short term. **Partially observed** means that while the legal and regulatory framework complies with the OECD Principles, practices and enforcement diverge. **Materially not observed** means that, despite progress, the shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance. **Not observed** means that no substantive progress toward observance has been achieved.

candidates for outside directors on the slate prepared by the outside directors nomination committee. Cumulative voting was introduced to the CC in 1998. However, more than 80 percent of the listed firms have now opted out of cumulative voting. Shareholder activists have recommended that cumulative voting be made mandatory.

Policy recommendation: Consider taking additional steps to allow minority shareholders a greater voice in the selection of directors, including making cumulative voting more appealing for large listed companies. Consider further strengthening the role of the outside directors nomination committee by, for instance, requiring that at least two thirds of the members of such a committee be independent directors.

(6) Share in the profits of the corporation. Under the CC, shareholders are entitled to dividends in proportion to their shareholdings. It is the GSM, not the board of directors, which has the ultimate power to declare dividends under the CC. Although it is quite rare that a dividend proposal made by management is defeated in the GSM, management is now under strong pressure for more dividends.

Policy recommendation: Consider conducting further studies and analysis of who should have the ultimate power to declare dividends. Consider strengthening the power of the boards of directors of public companies under the Securities Transactions Act, which gives them the power to declare dividends.

Principle IB. Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes, such as: (1) Amendments to the governing documents of the company; (2) The authorization of additional shares; (3) Extraordinary transactions that in effect result in the sale of the company.

Assessment: Observed

Description of practice: **(1) Amendments to the governing documents of the company.** Revision of the articles of incorporation requires a special resolution of the GSM, which requires a two thirds majority of the votes represented at the meeting (this must be not less than one third of the total shares). Under the CC, companies are required to notify the shareholders of the agenda of GSM two weeks in advance. Under the SEA and the Regulations on Securities Issuance and Disclosure, listed companies also are required to provide the shareholders with detailed referential materials by each agenda item of the GSM in addition to notification.

(2) The authorization of additional shares. The authorized shares at the time of incorporation are included in the articles of incorporation. The number of shares issued at the time of incorporation shall be no less than one-fourth of the number of authorized shares. Within the limit of the authorized shares, the board of directors may issue new shares. If the corporation wishes to extend the limit, it must change the articles of incorporation, which requires a special resolution at the GSM.

(3) Extraordinary transactions that in effect result in the sale of the company. Under the CC, a special resolution is required for a transaction that may result in the sale of the corporation (or a substantial part of the corporation). For such transactions involving listed companies, the SEA imposes additional disclosure and substantive requirements.

Principle IC. Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern them.

Assessment: **Largely observed**

Description of practice: **(1) Sufficient and timely information about shareholders' meeting.** Under the CC, the corporation must send the notice of a GSM at least 2 weeks prior to the date of such a meeting. Such notice may be given electronically now, and it must include the agenda of the meeting. The CC does not provide any detailed guidelines for information to be disclosed in the notice. The SEA now requires listed companies to disclose any detailed material information to the shareholders in addition to the notice as articulated in the Regulations on Securities Issuance and Disclosure, etc. Two weeks advance notice may not be long enough for foreign institutional investors holding depository receipts, as they need more time to cast votes and to obtain clearance internally from compliance officers and global custodians. Investors are also required to give voting instructions at least 10 days prior to the meetings. This poses a substantial obstacle to anyone who desires to attempt proxy solicitation.⁸

Policy recommendation: It is recommended to consider further steps to facilitate voting by foreign investors.

(2) Opportunity to ask questions and place items on the agenda. Although the CC is silent, it is generally agreed that individual shareholders are entitled to ask questions to the board members at the meeting. It is widely agreed that directors are obliged to answer questions to a reasonable extent. Shareholders holding over a certain number of shares - 3 percent for non-listed companies, 1 percent for listed companies, and 0.5 percent for large listed companies - have the right to propose an item for the agenda. But such a request must be made at least 6 weeks in advance of the proposed GSM. As the notice of the GSM is given only 2 weeks in advance, it is difficult, if not impossible, for an individual shareholder to exercise the proposal right in an extraordinary GSM. Shareholders holding over 3 percent (1.5 percent for large listed companies with capital greater than 100 billion) of the outstanding shares may even convene an extraordinary GSM with a court injunction.

(3) Vote in person or absentia. Shareholders may exercise their voting rights by proxy. If a formal proxy solicitation is undertaken, a proxy statement that includes certain information for the shareholders is to be provided. In practice, unless there is a dispute with dissenting shareholders, firms rarely undertake a formal proxy solicitation. Since 1999, shareholders have been permitted to vote by mail, if so provided for in the articles of incorporation. Not many companies have adopted this system, however. There is no rule on how votes are cast. The vote may be cast by show of hand or by poll, or by any other reasonable method.

Policy recommendation: It is recommended a mechanism be instituted to further facilitate shareholders' votes by ballot so that this system can be more widely implemented. Shareholders should be allowed to cast votes electronically as well.

Principle ID. Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

Assessment: **Largely observed**

⁸ Kim and Kim, "Shareholder Activism in Korea," *Journal of Korean Law*, No. 51, page 60-61.

Description of practice: The SEA has provided for the so-called 5 percent rule, which requires any person who, with his affiliates, controls 5 percent or more of the total outstanding voting shares of a listed firm, to report his holdings to the FSC and the KSE within five days of such an acquisition. Under the law, distribution of voting power in Korean firms is quite clear. Under the CC, the one share-one vote principle is explicitly stated. Dual class common stock is not allowed, with the exception of nonvoting preferred shares.

Policy recommendation: Consider requiring further disclosure of cash flow rights and voting rights of the controlling shareholder, including affiliated corporations, to make it easily understandable to the average shareholder.

Principle IE. Markets for corporate control should be allowed to function in an efficient and transparent manner.

Assessment: **Largely observed**

Description of practice: **(1) Clearly articulated and disclosed rules and procedures.** The SEA provides a set of detailed tender offer rules, which regulate substantive as well as disclosure aspects of the tender offer. Currently, a mandatory tender offer rule remains in a limited way. Anyone who intends to acquire 5 percent or more of the shares from ten shareholders outside the stock market must undertake a formal tender offer.

(2) No use of anti-takeover devices to shield management from accountability. Anti-takeover devices have not been well developed in Korea, largely because controlling shareholders could establish a stable control block through pyramiding and cross ownership schemes. Poison pills are generally regarded as unavailable in Korea as they are in conflict with the CC.

Policy recommendation: It is recommended that a study be conducted on how to make the market for corporate control work more effectively.

Principle IF. Shareholders, including institutional investors, should consider the costs and benefits of exercising their voting rights.

Assessment: **Partially observed**

Description of practice: As in most other countries, small shareholders in Korea have little interest in attending shareholders' meetings. When they do attend meetings, their impact often is insignificant, because a substantial block of the shares is securely in the hands of a few controlling shareholders. Even the voices of institutional shareholders have been relatively weak. Domestic institutional investors have been either members of *chaebol* groups or interested in maintaining a close business relationship with them. In most cases, foreign investors have been either uninterested or unable to overcome administrative difficulties involved in the voting process. There are some signs of change, however. Institutional investors such as investment trusts and mutual funds are now required to disclose their specific voting intentions prior to the GSM. The Fair Trade Act allows affiliated financial institutions to exercise voting rights to a certain extent in the shareholder meeting of an affiliated firm.

Policy recommendation: While progress has been made, domestic institutions are still not well aware of the importance of voting in corporate governance. The importance of voting rights of beneficiaries and the idea that these rights should be exercised solely in their interest should be explicitly made clear in relevant legislation. Further effort should be expended to strengthen the institutional investor base through pension system reform to spur capital market development

and to place old-age insurance on a sustainable foundation.

Section II: Equitable Treatment of Shareholders

Principle IIA. The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights. All shareholders of the same class should be treated equally.

Assessment: **Largely observed**

Description of practice: **(1) Legal redress to shareholders if their rights are violated.** Shareholders may file a derivative action against directors, statutory auditors and controlling shareholders. The threshold holding has been reduced from 5 to 1 percent for non-listed firms, and as low as 0.01 percent for listed firms. Due to various obstacles, such as a lack of incentive on the part of plaintiffs (and lawyers), derivative suits are rarely initiated. Class action lawsuits are not available in Korea yet. There is draft legislation in the National Assembly to allow class action law suits for limited securities cases.

Policy recommendation: It is recommended that class action lawsuits be introduced as soon as possible to enable shareholders and investors to sue directors, managers, and auditors for breaches of duty and violations of the law.

(2) Same voting rights for shareholders within each class. Under the CC, dual class common stock is prohibited. Shares with fractional or multiple votes may not be issued in Korea. Each share is given one vote in principle. The only exception is nonvoting preferred shares. Although preferred shares may be issued with or without vote, the voting right element should be indicated in the articles of incorporation.

(3) Votes by custodians or nominees in agreement with the beneficial owner. Currently, an overwhelming majority of shares of listed firms is deposited with the KSD. As the beneficial owner, not the KSD, is explicitly regarded as real shareholder under the SEA, he is entitled to vote directly or indirectly by giving instruction to the KSD. If the beneficial owner fails to give instruction, the KSD may cast votes in compliance with the so-called shadow voting rule, which requires the KSD to vote in proportion to the voting results of other shareholders. In practice, there has been no instance where the KSD fails to comply with these voting regulations. Voting rights of foreign investors are less perfectly protected. Foreign investors directly holding shares in Korea are treated the same as domestic shareholders. Foreign investors holding Depository Receipts (DRs) are treated differently in accordance with the deposit agreement. In some cases, DR holders are not given an opportunity to express their voting instructions under the contract.

Policy recommendation: It is recommended that, in order to allow more time for voting, the notice period be extended to four weeks, at a minimum, for listed firms.

(4) Processes and procedures for shareholder's meetings allow for equitable treatment. Shareholders must be treated equally in proportion to their shareholding. Notice must be given to each shareholder regardless of his or her shareholding. The SEA allows a listed firm to bypass individual notices to shareholders with 1 percent or less by making newspaper announcements.

Principle IIB. Insider trading and abusive self-dealing should be prohibited.

Assessment: Partially observed

Description of practice: Securities trading based on material non-public information is strictly prohibited under the SEA. Violators shall be subject to imprisonment and criminal fine, and may be held liable for damages. In addition, the SEA provides for the disgorgement of short-swing profits. Any profits gained by a corporate insider of a listed firm through sales and purchases executed within six months must be returned to the firm. To help enforce this rule, the SEA requires such insiders to report their holdings to the regulatory authorities. The Securities and Futures Commission has the responsibility to closely monitor insider trading and market manipulation.

Self-dealing involving directors requires an approval by the board under the CC. Related party transactions are widespread in Korea, but since they involve controlling shareholders or more often affiliated persons, rather than directors, they are not covered by the CC. Under the SEA revised in 2001, a large listed firm is required to get approval of the board and report to the GSM for a transaction with the largest shareholder or its affiliate. A rule of similar content is included in the Monopoly Regulation and Fair Trade Act. Korea's Commercial Code already bars directors facing potential conflicts of interest from voting in the directors' meeting. However, conflict of interest is narrowly defined and inside directors are often allowed to vote.

Policy recommendation: It is recommended that further steps be taken to strengthen self-dealing and insider trading rules by, for instance, excluding inside directors from decisions that involve potential conflicts-of-interest or related party transactions. Another consideration would be to impose on the insider the burden of proving fairness of the transaction unless it is approved by the outside directors. Additionally, the accounting standard concerning related party transactions needs to be improved to be fully consistent with the international accounting standard.

Principle IIC. Members of the board and managers should be required to disclose any material interests in transactions or matters affecting the corporation.

Assessment: Partially observed

Description of practice: There is no specific requirement in the CC for disclosure of conflict of interest on the part of directors or managers. The only relevant provision under the CC requires directors who engage in a transaction with the corporation to obtain approval from the board. As directors must seek board approval for certain conflict-of-interest transactions such as self-dealing, it may be reasonable to presume that the director concerned is obliged to disclose to the board the nature of the conflict, just as one may presume that under the CC directors are generally required to disclose to the board any potential conflict of interest with the firm. In practice, however, such disclosure is not enforced. If the conflict of interest involves a controlling shareholder, it is not generally believed that the controlling shareholder has any such duty to disclose.

Policy recommendation: It is recommended that it should be made explicit under the CC that directors, controlling shareholders and other related parties are obliged to make a full disclosure to the board on the related party transaction in question.

Section III: Role of Stakeholders in Corporate Governance

Principle IIIA. The corporate governance framework should recognize the rights of the stakeholders as established by law and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises. The corporate governance framework should assure the rights of stakeholders that are protected by law are respected.

Assessment: Partially observed

Description of practice: In Korea, the corporate governance framework does not explicitly address the interests of stakeholders, such as employees and labor unions, suppliers, local community, and so forth. Stakeholder related issues such as anti-bribery and anti-corruption provisions are specifically addressed in the CC and the Act on the Aggravated Punishment, etc. of Specific Economic Crimes, and such crimes are punishable. Creditor interests, however, are well respected in various contexts under the CC. The CC and SEA are largely silent on the interest of employees, with a notable exception for Employee Stock Ownership (ESOP). In practice, management takes the labor interests quite seriously to avoid potential labor unrest. It is only recently that management started paying attention to social issues such as environmental and anti-discrimination issues.

Policy recommendation: While there is no consensus on the extent to which stakeholders' interests must be reflected in the corporate governance framework in Korea, there is no question that a minimum requirement should be established. It is recommended that further consideration be given on how to ensure better representation and protection of the rights of stakeholders.

Principle IIIB. Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

Assessment: Observed

Description of practice: Employee interests are the ones most explicitly protected by law in Korea. Labor statutes provide legal remedies for violation of any of their rights.

Principle IIIC. The corporate governance framework should permit performance-enhancing mechanisms for stakeholder participation.

Assessment: Largely observed

Description of practice: Under the SEA, employees of a listed firm are entitled to purchase newly issued shares up to 20 percent. This has often turned out to be a profitable option to employees, as the new shares are usually issued at a substantial discount. Also, both the CC and the SEA now allow firms to grant stock options and stock appreciation rights to their employees. It is now becoming common practice among start-up companies to grant stock options to their key employees.

Principle IIID. Where stakeholders participate in the corporate governance process, they should have access to relevant information.

Assessment: Observed

Description of practice: It is only creditors who are allowed to participate in the corporate governance process even to a limited extent. Creditors are given access to such corporate information as available from the financial statements, business report, audit report, the articles of incorporation, the minutes of the GSM, and the Register of Shareholders. Stakeholder participation in the corporate governance process is not widely supported in Korea.

Section IV: Disclosure and Transparency

Principle IVA. The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance of the company. Disclosure should include, but not be limited to, material information on: (1) The financial and operating results of the company; (2) Company objectives; (3) Major share ownership and voting rights; (4) Members of the board and key executives, and their remuneration; (5) Material foreseeable risk factors; (6) Material issues regarding employees and other stakeholders; and (7) Governance structures and policies.

Assessment: **Largely observed**

Description of practice: **(1) The financial and operating results of the company.** Under the CC, financial statements must be approved by the annual GSM. The balance sheet must be published in a daily newspaper upon approval. The business report is prepared mainly for delivering non-financial information such as relationship with parent company or subsidiaries, information on major shareholders and major creditors, important events occurred after the closing of the preceding fiscal year, etc. Directors must submit this business report to the annual GSM. Disclosure to the investment community is regulated under the SEA. A listed company must submit annual, semi-annual, and quarterly reports to the FSC and the KSE. When a material event occurs, listed companies must notify the FSC and the KSE of the event without delay.⁹ Failure to comply with this disclosure duty may result in regulatory actions. Directors are held liable for damages caused by any misrepresentation.

Policy recommendation: It is recommended that financial and operating results of companies be published with a level of detail consistent with international best practices.

(2) Company objectives. The CC requires a company to specify the company objectives in the articles of incorporation. The objectives must be included in the annual report. Change in the company objectives must be notified to the FSC and the KSE without delay.

(3) Major share ownership and voting rights. Share ownership information is available from the Register of Shareholders and the Register of Beneficial Owners, both of which are accessible. In practice, the Register of Shareholders does not show the full picture because in that register, the KSD, the official stock depository, rather than actual shareholders, is normally recorded as the largest shareholder. The SEA requires, therefore, that any issuing company or stock transfer agent prepare and keep a Register of Beneficial Owners upon receiving a notification of the classes and numbers held by the real stakeholders pursuant to the deposited securities from KSD.

(4) Members of the board and key executives, and their remuneration. The CC requires the compensation of directors and statutory auditors to be determined at the GSM. In practice, however, the GSM approves of only the cap on compensation of the board members and statutory auditors. Disclosure of the remuneration of individual directors is not required.

(5) Material foreseeable risk factors. No statute prevents a listed firm from disclosing material foreseeable risk factors. But no statute specifically requires a listed firm to disclose them either. Disclosure of soft information on prospective financial condition or business performance may be made under certain conditions.

⁹ Under the Regulations on the Fair Disclosure, which became effective on Nov. 1, 2002, listed companies must disclose any material information publicly when such information is given to a selected group of people. With the introduction of the RFD, the protection of investors and the transparency in the Korean securities market are expected to be enhanced.

Policy recommendation: It is recommended that listed corporations should be required to disclose in the annual reports the level of individual compensation of top management and directors at a minimum. It is recommended that the SEA be revised to explicitly require listed firms to disclose material foreseeable risk factors in a kind of MD&A attached to annual reports.

(6) Material issues regarding employees and other stakeholders. The annual report is required to cover employee-related matters, such as total number of employees, total wage amount, and average wage amount per employee, in the annual report.

(7) Governance structures and policies. Basic information on directors, including representative directors, is available from the corporate registry. Information on governance structure must be disclosed through the registration statement and annual report. Disclosure of information on governance policies is not required, however.

Principle IVB. Information should be prepared, audited and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit.

Assessment: Partially observed

There has been significant progress in upgrading accounting and auditing standards and practices and strengthening underlying institutions responsible for setting standards and ensuring compliance. Accounting standards have been improved significantly and are now largely consistent with international standards; the Korean Accounting Standards Board (KASB), an independent standard-setting organization, has been established; and auditing standards are now fully consistent with international standards. The regulators have also strengthened enforcement by imposing sanctions on accountants for violation of rules or laws. While accounting standards have been improved significantly, further improvements are required. Quality of accounting, financial and non-financial disclosure, and audit is not yet at the level of other OECD countries. The level of audit fees in Korea compared to other OECD countries is low, and audit fees are determined by management. Non-listed firms are subject to external audit if they have assets over 7 billion Won. Although improvements are underway, the quality of accounting disclosure is not yet adequate.

Policy recommendation: It is recommended that further improvement be made to accounting standards and auditing practices in a manner consistent with international standards and practices. Improvements should include the issuance of operating guidelines, training of accountants, enforcement of the Code of Ethics and professional code of conduct for accountants, and imposition of sanctions on auditors who violate their duties or professional code, or who commit fraud. The quality of accounting, financial and non-financial disclosures, and audit practices need to be further improved in order to be at the level of other OECD countries. It is also recommended that audit fees be determined by the audit committees rather than the management.

Principle IVC. An annual audit should be conducted by an independent auditor in order to provide external and objective assurance on the way in which financial statements have been prepared and presented.

Assessment: Largely observed

Description of practice: Under the Act on External Audit of Corporations (AEAC), a corporation with assets totaling seven billion Won must have the financial statements (including consolidated or combined financial statements) externally audited by qualified auditors. Auditors are required to comply with the auditing standards issued by the Korean Institute of Certified Public

Accountants (KICPA). Although the MOFE has the formal power to take a disciplinary measure against individual CPAs, the SFC plays a more significant role in sanctioning accounting firms as well as individual accountants. The KICPA has been planning to adopt a completely revised Code of Ethics modeled after the code of professional ethics adopted by the International Federation of Accountants (IFAC). This long overdue revised code needs to be adopted as soon as possible and put in effect.

Policy recommendation: It is recommended that a more detailed definition of independence be adopted in the AEAC or the CPA Act. An extensive detailed definition is now being prepared for inclusion in the new code of professional ethics expected to be adopted by the KICPA in the next few months.

Principle IVD. Channels for disseminating information should provide for fair, timely and cost-efficient access to relevant information by users.

Assessment: **Observed**

Description of practice: Under the CC, the financial statements include a balance sheet and an income statement, but not a statement of cash flows, which is included in the financial statements under the AEAC. Under the CC, only the balance sheet is to be published in a daily newspaper upon approval at the GSM. Also, the shareholder may access the financial statements, business report, and audit report kept at the principal office.

Section V: Responsibilities of the Board

Principle VA. The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interests of the company and the shareholders.

Assessment: **Largely observed**

Description of practice: Under the CC, the board should be in charge of the operation of the corporation. With a growing number of outside directors participating, the board's role in large listed firms has been substantially strengthened. Under the CC, directors owe fiduciary duties (duty of loyalty and duty of care) to the company. Directors who have breached their duties shall be jointly and severally liable for damages to the company. Although the CC does not explicitly provide the fiduciary duties to individual shareholders, some experts argue that directors owe fiduciary duties to individual shareholders as well.

Policy recommendation: It is recommended that the CC be revised to explicitly require that directors owe fiduciary duties to shareholders.

Principle VB. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

Assessment: **Partially observed**

Description of practice: Under the CC, management is not allowed to discriminate among shareholders of the same class. As long as shareholders are treated equally in a formal sense, however, the board is entitled to take any action. For example, the firm may forgo paying dividends or undertake a rights offering of substantial size, as those decisions apparently affect shareholders equally. Of course, the board is subject to the duty of care, but it is very difficult to

attack such decisions of the board on the grounds that they are in violation of the duty of care because in most cases the board decision will be respected by the court as business judgment.

Policy recommendation: It is recommended that the CC explicitly require that the board should treat all shareholders fairly. Under such a provision, it will be easier for the shareholders who are affected unfairly by a corporate decision to file a suit against management.

Principle VC. The board should ensure compliance with applicable law and take into account the interests of stakeholders.
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Assessment: Partially observed

Description of practice: It is generally agreed that directors' duty of care includes a duty to comply with applicable laws and regulations. Directors who have violated laws or regulations are to be held liable for any damages incurred to the firm. Moreover, the director's duty of care is believed to include a duty to establish a reasonable internal control system for preventing any potential violation of law by officers and employees. The Code of Best Practice provides that in performing the duties, the director shall always be careful to ensure that no laws are violated by the corporation or himself. There is a requirement that companies must establish an internal accounting management system and attach to their annual reports an evaluation of their internal control system by external auditors. While this requirement partially addresses responsibility of various parties in the operation and evaluation of internal control systems, it does not clearly distinguish and define the responsibilities of the management (CEO and CFO), boards of directors, internal auditors, and external auditors, particularly with regards to compliance with applicable laws and regulations. Additionally, implementation of the current requirement does not fully meet international standards and best practices.

Policy recommendation: It is recommended that the scope of current effort to consider certification of CEOs by independent auditors be expanded. In doing so, consider requiring management (CEOs and CFOs) of large listed companies to include in their annual reports a statement on their responsibilities for establishing and maintaining adequate internal controls over financial reporting and compliance with applicable laws and regulations, as well as an assessment of effectiveness of their internal control system consistent with international best practices. Such an assertion should be certified by the external auditor.¹⁰

Principle VD. The board should fulfil certain key functions, including the following: (1) Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures; (2) Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning; (3) Reviewing key executive and board remuneration, and ensuring a formal and transparent board nomination process; (4) Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions; (5) Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law; (6) Monitoring the effectiveness of the governance practices under which it operates and making changes as needed; and (7) Overseeing the process of disclosure and communications.
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¹⁰ An example of good practice is the recent Sarbanes-Oxley Act of 2002 in the U.S. that requires each annual report of an issuer to contain an "internal control report." Each issuer's auditor needs to attest to and report on the assertion made by the management of the issuer.

Assessment: Largely observed

Description of practice: No laws or regulations specify the responsibilities of the board in relation to the listed tasks. The CC only provides that the board may decide the business affairs of the company and may supervise the management. Thus, unless otherwise provided for in the CC or the articles of incorporation, the board has in principle power over all matters of the corporation. Large listed companies have been required to establish audit committees of the boards of directors. However, the concept is new, and audit committees are generally perceived to be neither effective nor adequately equipped to effectively discharge their oversight responsibilities. Efforts should continue to improve the effectiveness of audit committees, including measures to clarify and strengthen the role and function of audit committees consistent with international best practices; replace statutory auditors with audit committees for smaller companies over time,¹¹ and upgrade the skills and knowledge of audit committee members.

Policy recommendation: It is recommended that effectiveness of audit committees be improved, including measures to clarify and strengthen the role and function of audit committees, consistent with international best practices¹². It is recommended that consideration be given to upgrading the directors' training program to a directors' certification program. It is also recommended that consideration be given to making the code mandatory as part of compliance with the listing rules.

Principle VE. The board should be able to exercise objective judgment on corporate affairs independent, in particular, from management.
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Assessment: Partially observed

Description of practice: **(1) Sufficient number of non-executive board members.** Prior to the financial crisis of 1997, outside directors were very rare in Korea's corporate community. The SEA now requires listed companies to fill at least one quarter of the board with outside directors. The statutory minimum is 50 percent (three outside directors at least) for financial institutions and large listed companies. Non-listed companies are not required to have outside directors, but if they voluntarily establish an audit committee instead of statutory auditors, at least two thirds of the committee members shall be outside directors. However, the more important issue is whether these outside directors act truly as independent directors.¹³ This is changing gradually, and outside directors in large firms, particularly the ones with foreign investors, are increasingly acting independently.

(2) Board members should devote sufficient time to their responsibilities. Directors should attend the board meeting. A failure to attend does not bring any disadvantage to the absent director under the CC. There is a lower court decision holding that a failure to attend a board meeting alone does not constitute a breach of fiduciary duty. Directors now feel more pressure to attend board meetings, as listed companies must disclose information on the attendance records of directors.

Policy recommendation: In order to ensure that directors act independently of management,

¹¹ Under the SEA, establishment of an audit committee is mandatory for listed companies with assets of at least 2 trillion Won. As of December 31, 2001 only 12 percent of listed firms had set up an audit committee.

¹² Examples of good practices are the Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees and the recent recommendations of the NYSE Listing Committee issued in 2002.

¹³ According to a study by the KSE at the end of year 2000, outside directors supported management in 99.3 percent of their key decisions. About 80 percent of outside directors were nominated by management or the main shareholder, typically the family of the *chaebol* founder.

consider further clarifying what constitutes independence and conflicts-of-interest for individual directors.

Principle VF. In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.

Assessment: ***Partially observed***

Description of practice: With the enhancement of related regulations, outside directors of listed companies are expected to be informed of BOD meetings four or five days in advance. The Code of Best Practice for Corporate Governance sets forth a series of provisions to enable directors to gain access to more information. In practice, in a number of listed firms under professional management, outside directors are given almost unlimited access to corporate information. However, further effort will be required to ensure that individual directors will have adequate access to necessary information.

Policy recommendation: It is recommended that the rights of individual directors, particularly independent directors in the SEA, be further expanded and clarified to give them access to all corporate information necessary to perform their duties.

Annex A: OECD Principles-Assessment Matrix

Section I: The Rights of Shareholders

Principle IA. Basic shareholders rights:

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input checked="" type="checkbox"/>	(e) Partially observed	<input type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle IB. The right to participate in decisions on fundamental corporate changes:

(a) Observed	<input checked="" type="checkbox"/>	(b) Largely observed	<input type="checkbox"/>	(e) Partially observed	<input type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle IC. The right to be adequately informed about, participate and vote in general shareholder meetings (AGM):

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input checked="" type="checkbox"/>	(e) Partially observed	<input type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle ID. Disclosure of capital structures and arrangements enabling control disproportionate to equity ownership:

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input checked="" type="checkbox"/>	(e) Partially observed	<input type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle IE. Efficient and transparent functioning of market for corporate control:

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input checked="" type="checkbox"/>	(e) Partially observed	<input type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle IF. Requirement to weigh costs/benefits of exercising voting rights

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input type="checkbox"/>	(e) Partially observed	<input checked="" type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Section II: The Equitable Treatment of Shareholders

Principle IIA. Equal treatment of shareholders within same class

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input checked="" type="checkbox"/>	(e) Partially observed	<input type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle IIB. Prohibition of insider trading and self-dealing

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input type="checkbox"/>	(e) Partially observed	<input checked="" type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle IIC. Disclosure by directors and managers of material interests in transactions or matters affecting the

company.

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input type="checkbox"/>	(e) Partially observed	<input checked="" type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Section III: The Role of Stakeholders in Corporate Governance

Principle IIIA. Respect of legal stakeholder rights as established by law

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input type="checkbox"/>	(e) Partially observed	<input checked="" type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle IIIB. Redress for violation of rights

(a) Observed	<input checked="" type="checkbox"/>	(b) Largely observed	<input type="checkbox"/>	(e) Partially observed	<input type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle IIIC. Performance-enhancing mechanisms for stakeholder participation

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input checked="" type="checkbox"/>	(e) Partially observed	<input type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle IIID. Access to relevant information

(a) Observed	<input checked="" type="checkbox"/>	(b) Largely observed	<input type="checkbox"/>	(e) Partially observed	<input type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Section IV: Disclosure and Transparency

Principle IVA. Timely and accurate disclosure of material information

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input checked="" type="checkbox"/>	(e) Partially observed	<input type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle IVB. Preparation of information, audit, and disclosure in accordance with high standards of accounting, disclosure and audit.

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input type="checkbox"/>	(e) Partially observed	<input checked="" type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle IVC. Annual audit by independent auditor

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input checked="" type="checkbox"/>	(e) Partially observed	<input type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle IVD. Channels for disseminating information allow for fair, timely, and cost-efficient access to information by users

(a) Observed	<input checked="" type="checkbox"/>	(b) Largely observed	<input type="checkbox"/>	(e) Partially observed	<input type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Section V: The Responsibilities of the Board

Principle VA. Act on an informed basis, in good faith, with due diligence and care, in the best interest of the company and shareholders

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input checked="" type="checkbox"/>	(e) Partially observed	<input type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle VB. Fair treatment of each class of shareholders

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input type="checkbox"/>	(e) Partially observed	<input checked="" type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle VC. Compliance with law and taking into account stakeholders' interests

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input type="checkbox"/>	(e) Partially observed	<input checked="" type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle VD. Fulfillment of key functions, including corporate strategy, selection and monitoring of management, remuneration, board nomination, monitoring of conflict of interest including misuse of corporate assets and abuse in related party transactions, integrity of accounting, audit, governance practices and overseeing disclosure and communication.

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input checked="" type="checkbox"/>	(e) Partially observed	<input type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle VE. Objective judgment on corporate affairs, assignment of non-executive directors to tasks of potential conflict of interest; devotion of sufficient time.

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input type="checkbox"/>	(e) Partially observed	<input checked="" type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

Principle VF. Access to accurate, relevant, and timely information

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input type="checkbox"/>	(e) Partially observed	<input checked="" type="checkbox"/>
(c) Materially not observed	<input type="checkbox"/>	(d) Not observed	<input type="checkbox"/>		

*This table attempts to summarize the current provisions of listed companies in Korea, benchmarked against the **OECD Principles of Corporate Governance**. Each OECD Principle is evaluated based on quantitative and qualitative standards.*

Observed means that all essential criteria are generally met without any significant deficiencies. **Largely observed** means that only minor shortcomings are observed, which do not raise questions about the authorities' ability and intent to achieve full observance in the short term. **Partially observed** means that while the legal and regulatory framework complies with the OECD Principles, practices and enforcement diverge. **Materially not observed** means that, despite progress, the shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance. **Not observed** means that no substantive progress toward observance has been achieved.

Annex B: Recommended Plan of Key Actions to Improve Observance of OECD Principles of Corporate Governance

Since 1998, Korea has laid a solid foundation for good corporate governance. Beyond the changes in legislation affecting corporate governance, the Government and the business community should take additional steps to: change incentives and further promote transparency of business practices, particularly among *chaebol* groups; to strengthen competition policies in order to expose *chaebol* and firms to stricter market discipline; to increase and enforce shareholder rights; and to improve disclosure and monitoring of related party transactions. Moreover, institutional investors, who play a key role in corporate governance in many OECD countries, are relatively less important in Korea due to the small size of the pension fund sector, an area that needs to be developed, given the rapid aging of the population.¹⁴

In order for Korea to deepen its equity market, it needs to build on the excellent progress made and continue to improve corporate governance practices in a manner consistent with other OECD countries and international best practices. Among the most important measures needed to improve such practices are the following:

Recommended Plan of Key Actions to Improve Observance of OECD Principles of Corporate Governance

Reference Practice	Recommended Action
I. Rights of Shareholders	<ul style="list-style-type: none"> • Consider taking additional steps to allow minority shareholders a greater voice in the selection of directors, including making cumulative voting more appealing for large listed companies. • Consider further steps to facilitate voting by foreign investors. • Improve the process for nomination of independent directors by, for instance, requiring that at least two-thirds of members of outside nomination committees be independent directors.
II. Equitable Treatment of Shareholders	<ul style="list-style-type: none"> • Introduce, as soon as possible, class action lawsuits by shareholders and investors against directors, managers, and auditors for breach of duty and violation of the law.¹⁵ • Consider allowing shareholders to cast votes electronically. • Require that directors, controlling shareholders, and other related parties make full disclosure to the board on related party transactions. • Consider further steps to strengthen self-dealing and insider trading rules, for instance, by excluding inside directors from decisions that

¹⁴ Financial assets of institutional investors relative to the size of economy for OECD countries was approximately 140 percent of GDP relative to 60 percent of GDP in Korea in the year 2000.

¹⁵ While finalizing the draft, the World Bank has been informed by Korean authorities of the following update: Legislation for allowing class-action lawsuits for securities violations is now pending at the National Assembly and is scheduled to take effect in July 2004.

Reference Practice	Recommended Action
	involve potential conflict-of-interest or related party transactions.
III. Role of Stakeholders in Corporate Governance	<ul style="list-style-type: none"> • Strengthen stakeholders' rights and their protection in the corporate governance framework. • Promote participation of active institutional investors and pension funds in the equity market. Further strengthen institutional investor base through pension system reform to spur capital market development and improved governance.¹⁶
IV. Disclosure and Transparency	<ul style="list-style-type: none"> • Further improve accounting standards and auditing practices in a manner consistent with international standards and practices.¹⁷ • Further improve quality of disclosure in annual and quarterly reports issued by listed companies, particularly in areas such as related party transactions, conflicts of interest on the part of directors and parties related to directors or managers, non-financial information, material foreseeable risk factors, and compensation of individual directors. • Consider requiring management (CEOs and CFOs) of large listed companies to include in their annual reports a statement on their responsibilities for establishing and maintaining adequate internal controls over financial reporting and compliance with applicable laws and regulations as well as an assessment of effectiveness of their internal control system consistent with international best practices. Such an assertion should be certified by external auditors. • Change the incentives for large <i>chaebol</i> to establish holding companies.
V. Responsibilities of the Board	<ul style="list-style-type: none"> • Continue to improve effectiveness of audit committee, including measures to clarify and strengthen the role and function of audit committees consistent with international best practices • Replace statutory auditors with audit committees for smaller companies over time, and upgrade the skills and knowledge of audit committee members. • Further strengthen the roles and responsibilities of directors, including expanding the fiduciary duty of directors and making it explicit under the law and limiting liability of independent directors in cases in which they have acted in good faith. • Upgrade the directors' training program to a

¹⁶ While finalizing the draft, the World Bank has been informed by Korean authorities of the following update: Efforts are underway to actively promote participation of institutional investors.

¹⁷ While finalizing the draft, the World Bank has been informed by Korean authorities of the following update: Relevant legislation is pending at the National Assembly.

Reference Practice	Recommended Action
	<p>directors' certification program, particularly for independent directors.</p> <ul style="list-style-type: none"> • Further expand and clarify the right of directors to access all corporate information necessary to perform their duties. • Further clarify what constitutes independence and conflicts-of-interest for individual directors.